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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
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JAN 27 2012
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COMMISSIONERS

GARY PIERCE – Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.

Docket No. E-01345A-11-0224

NRDC's SUMMARY OF TESTIMONY

Natural Resources Defense Council ("NRDC") by and through its attorney hereby files the attached Summary of Testimony of its Witness Ralph Cavanagh in the above-referenced matter.

RESPECTFULLY SUBMITTED this 27th day of January, 2012.

By ______________________
Laura E. Sanchez
NRDC
PO Box 65623
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ORIGINAL and 13 COPIES of the foregoing filed this 27th day of January, 2012 to:

Docketing Supervisor
Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

COPIES of the foregoing
electronically mailed or distributed
in hard copy this 27th day of
January, 2012 to:

All Parties of Record

By: ______________________

SUMMARY OF NRDC'S TESTIMONY

ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-11-0224

NRDC's witness, Ralph Cavanagh, filed Direct Testimony in this matter (dated November 17, 2011) and also filed Testimony in Partial Opposition to the Settlement Agreement (dated January 17, 2012).

Direct Testimony

Mr. Cavanagh's initial direct testimony filed on November 17, 2011, agreed with APS that its proposed EIA "is necessary given the [Commission's] ambitious Energy Efficiency Standard and increasing DG requirements," because "without [the EIA], successful energy efficiency programs – even at levels below that set by the Commission in the EES – create a significant disincentive for the utility with serious adverse financial impacts."[1] The company's General Rate Case Application appropriately links the EIA to "the Commission's recently approved decoupling policy statement," and indicates that the EIA would "address the loss in fixed cost recovery that occurs when the historical volumetric pricing structure is used in combination with increasing energy efficiency and distributed generation requirements."[2] To underscore the EIA's importance and urgency, APS notes that in its 2010 Test Year it collected more than two-thirds of the fixed costs of serving its residential and commercial through volumetric charges.[3]

Mr. Cavanagh concluded that the proposed EIA was entirely consistent with the Commission's decoupling policy statement, and he recommended its approval. His direct testimony summarizes experience with comparable revenue decoupling mechanisms and responds to concerns commonly raised about them. APS's proposal would remove a potent disincentive to the company's engagement with all forms of progress in energy efficiency and distributed generation, by ensuring that the Company recovers the fixed costs previously authorized by the Commission (but no more than that amount), notwithstanding any short-term fluctuations in metered electricity use. His testimony also shows that efforts to link rate adjustments specifically to energy efficiency program impacts would have perverse consequences and impede statewide progress in achieving cost-effective savings.

Testimony in Partial Opposition to the Settlement Agreement

Mr. Cavanagh's testimony on behalf of NRDC partially opposes the Settlement Agreement in this matter, specifically on the issue of adopting a Lost Fixed Cost Recovery (LFCR) mechanism. Mr. Cavanagh urges the Commission to approve Arizona Public Service Company's (APS) original proposal for an Efficiency and Infrastructure Account, which represents a straightforward decoupling mechanism of the very type endorsed in the Final Policy Statement adopted unanimously by the Commission in December 2010. The Commission's

[1] See Testimony of Leland R. Snook on behalf of APS, p. 2:17-28.
[2] Arizona Public Service Commission, Docket No. E-01345A-11-0224, Application (June 1, 2011), p. 6.
[3] See Testimony of Leland R. Snook, p. 3 (noting that APS collected 73% of residential sector fixed costs and 66% of commercial sector fixed costs, respectively, through kWh charges).

recent decision in favor of decoupling in the Southwest Gas case included a thorough review of policy and legal issues, and signaled no retreat from the Final Policy Statement. That same document is cited repeatedly in Mr. Cavanagh's direct testimony as the primary basis for NRDC's support of APS's original revenue decoupling proposal in this proceeding.

NRDC joins SWEEP in urging the Commission to adopt full decoupling, while Staff and others contend that the Commission should adopt an inferior alternative in the form of the LFCR mechanism. The only relevant difference between the APS and Southwest Gas proceedings is that the Southwest Gas case framed the choice as part of a proposed Settlement Agreement (which NRDC joined), whereas in this case the proposed Settlement Agreement attempts to prevent the Commission from making the same choice, by including only the inferior alternative in the body of the Agreement. Mr. Cavanagh recommends that the Commission decide this case in the same way it resolved the Southwest Gas case: approve the Settlement Agreement, but substitute decoupling (in the form of the original APS proposal) for lost fixed-cost recovery.

The direct testimony of witnesses for Staff, AARP and RUCO prior to the settlement opposed APS's revenue decoupling. The arguments could be and no doubt have been used in many other states to oppose revenue decoupling and support straight fixed-variable rate design. But as an invited and active participant in the 2010 decoupling workshops that preceded the Commission's Final Policy Statement, Mr. Cavanagh testifies that in Arizona, witnesses need at minimum to acknowledge and accommodate the Commission's analysis and conclusions. Opponents of decoupling in this case have conspicuously failed to do so.

The LFCR Mechanism is Inadequate

Mr. Cavanagh explains why the LFCR in the Settlement is not a reasonable alternative to full decoupling. First, the Commission in its Final Policy Statement stated a clear preference for "full decoupling" compared to "lost margin recovery mechanisms" *(pp 28-29). Moreover, in* contesting the LFCR provision here, NRDC and other parties are giving the Commission the opportunity to make exactly the same choice that it faced in the recent Southwest Gas case. In that matter, a stipulation joined by both Staff and NRDC asked the Commission to select either a LFCR mechanism (Alternative A, favored by Staff) or full revenue decoupling (Alternative B, favored by NRDC and SWEEP). The Commission chose Alternative B, reaffirming the preference stated in its Final Policy Statement:

> [A] partial decoupling mechanism such as is included in Alternative A could create conflicting incentives for the Company by, on the one hand, imposing significant energy efficiency goals that must be achieved while, on the other hand, leaving in place a structure that would concurrently provide an incentive for SWG to sell higher volumes of gas in order to improve its bottom line, thereby undermining the Policy Statement's goal of encouraging conservation. Another concern raised by Alternative A is the nature of the annual proceedings that would be required to review the performance of the LFCR mechanism, and the likelihood that those proceedings would be extremely adversarial as parties were forced to litigate on a yearly basis whether SWG had achieved the required energy efficiency goals. Further, as Mr. Cavanagh pointed out, adoption of Alternative A

may cause SWG to pursue energy efficiency programs that look good on paper but deliver much less in actual savings.[4]

Mr. Cavanagh testifies that the Settlement Agreement is really just trying to resurrect Alternative A (the LFCR mechanism) from the Southwest Gas case, in an attempt to displace another clearly preferable full decoupling mechanism.

Mr. Cavanagh comments on the Settlement's"opt-out" option for its LFCR mechanism, which requires customers to accept higher fixed charges and reductions in the rewards that they would otherwise receive in their APS bills for saving electricity. The Commission's Policy Statement considered this rate design option and noted that it would adversely affect low-income customers and discourage efficient energy use.[5] In the Commission's own words, this move toward "fixed cost/variable pricing" and larger customer charges would mean "reduced variable charges, which discourages efficient energy use."[6]

From a consumer perspective, Mr. Cavanagh testifies that the one percent rate cap in the Settlement Agreement's LFCR mechanism would not be preferable to the three percent rate cap in the original APS decoupling proposal because the LFCR represents an automatic rate increase, whereas decoupling can either raise or reduce rates. Also, he holds that an even more undesirable element of the Settlement Agreement is that it undercuts APS's incentive to achieve or exceed Arizona's energy efficiency targets and accompanying bill savings "on the order of $4.6 billion between 2011 and 2030".[7]

The Settlement Agreement impairs those incentives because it does not make APS whole for lost fixed costs even from those sales that APS is judged to have lost as a result of its programs. The proposed LFCR affects only "a portion of distribution and transmission costs," and entirely omits fixed costs of generation.[8] This means that even for savings potentially eligible for fixed cost recovery under the Settlement Agreement, APS would be better off financially if it gave up the savings and received instead equivalent increases in retail sales. And of course, in the words of the Final Policy Statement, all other electricity savings would automatically "impact recovery of fixed costs and investment returns," even as "sales growth . . . offers the opportunity to recover fixed costs and earn profit;" this is precisely the dilemma that the Commission aimed to eliminate in its Statement and its subsequent Southwest Gas decision.[9] The Proposed Settlement Agreement leaves this dilemma largely unaddressed.

Mr. Cavanagh also responds to RUCO's legal objections to revenue decoupling and AARP's critique.

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[4] Decision No. 72723, Docket No. G-01551A-10-0458 (January 6, 2012), pp. 39-40.
[5] Arizona Corporation Commission, Final Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures, Docket Nos. E-00000J-08-0314 and G-00000C-08-0314 (December 29, 2010) ("Final Policy Statement"), p. 28.
[6] Final Policy Statement, note 5 above, p. 28.
[7] Id., p. 20 (comparing "high efficiency scenario" to "the business as usual case" for APS).
[8] Proposed Settlement Agreement, p. 10, section 9.3.
[9] See Final Policy Statement, note 5 above, p. 2 and Decision No. 72723, note 4 above.

NRDC's Recommendation

Mr. Cavanagh recommends that the Commission resolve the decoupling issue as it did in the Southwest Gas case, by approving the Settlement Agreement except for section IX, which describes the Lost Fixed Cost Recovery option. The Commission should substitute for that option the original APS decoupling proposal, as described and supported in Mr. Cavanagh's Direct Testimony.